

AMERICAN RESOURCES MANAGEMENT CORP.

IBLA 79-10 Decided April 5, 1979

Appeal from decision of the Director, Geological Survey, holding that 22 oil and gas leases committed to the Blair Mesa Unit were not extended and had expired.

Affirmed.

1. Oil and Gas Leases: Extensions—Oil and Gas Leases: Suspensions—Oil and Gas Leases: Termination

The provision in a unit agreement allowing suspension of production requirements for unavoidable delays does not supplant the lessee's responsibility to comply with the procedure set out in the regulation for obtaining a suspension. A written application for suspension must be filed in triplicate with the area oil and gas supervisor prior to the expiration of the leases.

2. Oil and Gas Leases: Extensions—Oil and Gas Leases: Suspensions—Oil and Gas Leases: Termination—Oil and Gas Leases: Well Capable of Production

Suspension of production requirements for leases on which there are no wells capable of producing in paying quantities must be approved by the Secretary; this authority is not delegated to other officers below the Secretarial level.

3. Administrative Procedure: Generally—Hearings—Oil and Gas Leases: Termination—Oil and Gas Leases: Well Capable of Production—Rules of Practice: Hearings

Where the Geological Survey, in making its decision, has reviewed the same information

submitted on appeal to the Board of Land Appeals to show that there was a well capable of producing oil or gas in paying quantities on the date the lease expired, and there are no disputed facts, but only a dispute on the proper application of the law to those facts and legal interpretations, a hearing is not warranted in the case.

4. Oil and Gas Leases: Extensions—Oil and Gas Leases: Production—Oil and Gas Leases: Termination—Oil and Gas Leases: Well Capable of Production—Words and Phrases

"A well capable of producing oil or gas in paying quantities." The provision in 30 U.S.C. § 226(f) (1976) referring to a well capable of producing oil or gas in paying quantities refers to a well which is actually in physical condition to produce a sufficient quantity of oil or gas to yield a reasonable profit over and above the costs of operating the well and marketing the product. A satisfactory test of a well to establish its capability as of the termination date is necessary. Evidence which only supports inferences is not sufficient, nor is a showing only of a potential prospect for profitable operation at some future time.

APPEARANCES: Leroy S. Axland, Esq., and Larry G. Reed, Esq., of Suttler, Axland & Armstrong, Salt Lake City, Utah, for appellant.

OPINION BY ADMINISTRATIVE JUDGE THOMPSON

American Resources Management Corp. (ARMCOR) appeals from the decision of the Director, Geological Survey, dated August 28, 1978, affirming the district engineer's September 19, 1977, decision letter, denying extensions of 22 oil and gas leases for lack of production in paying quantities as of September 1, 1977. ^{1/} These noncompetitive oil and gas leases, listed in attached Appendix A, were issued after 1960 for primary terms of 10 years, and in 1973 they were committed

^{1/} There were originally 24 leases involved in this case. Leases C-0100022 and C-0100122 are committed to productive communitization agreements and the Director held these leases were extended by production under those agreements.

to the Parker Unit. On September 1, 1975, the leases were eliminated from the Parker Unit and thereby extended for 2 years to midnight September 1, 1978, and "so long thereafter as oil or gas is produced in paying quantities." 30 U.S.C. § 226(j) (1976); 43 CFR 3107.5.

Appellant, the unit operator, applied for a unit area designation covering these leases on April 16, 1976, which was obtained on June 8, 1976. The documents required to be filed by 30 CFR Part 226 prior to approval of a unit agreement were filed in February and March of 1977. The leases were committed to the Blair Mesa Unit on April 19, 1977.

The Applications for Permits to Drill the four existing wells were approved May 12, 1977, for wells Nos. 17-1, 17-2, and 17-3. Well No. 18-1-S was initially approved under the Parker Unit, and approval was reinstated by Sundry Notice on February 15, 1977, under the Blair Mesa Unit. According to appellant, due to difficulty obtaining equipment, drilling on the four wells began June 3, 1977, and they were cased July 14, 1977. Problems with personnel, faulty cementing and fresh water leakage caused further delay and on August 5, 1977, appellant notified the district engineer of the problems. The casings were perforated and the No. 17-1 well was fractured prior to the termination date of the leases, September 1, 1977.

According to appellant's brief, on September 1, 1977, the Casper, Wyoming, Survey office instructed it to abandon the property as the leases had expired at midnight August 31, 1977. Later on September 1, 1977, the district engineer informed ARMCOR that the leases did not expire until midnight September 1, 1977, and authorized it to continue development of the wells. On September 2, 1977, ARMCOR was instructed to prepare the wells for testing. On September 19, 1977, a Schlumberger analysis was conducted on each well and submitted to the district engineer with a request for authorization to continue operations and conduct additional tests. This request was refused and ARMCOR appealed to the Director, Geological Survey.

Appellant advanced the same grounds for appeal to the Director that he now asserts before this Board. The reasons set forth in appellant's statement of reasons for appeal are:

1. The drilling and producing requirements of the leases in question have been suspended by virtue of the "unavoidable delay" provisions of the Blair Mesa Unit Agreement, therefore, said leases have not terminated.
2. The United States Geological Survey did not comply with the termination procedures required by 30 U.S.C. 226(f), therefore the subject leases have not expired.

3. In fairness and equity the Department of the Interior is estopped from asserting that the subject leases have terminated.

Appellant relies on section 17(f) of the Mineral Leasing Act of 1920, as amended, 30 U.S.C. § 226(f) (1976), which provides in part that no lease for lands on which there is a well capable of producing oil or gas in paying quantities shall expire for failure to produce same unless the lessee fails to place the well in a producing status within 60 days of receipt of a notice from the supervisor to do so, and that no lease issued thereunder "shall expire because operations or production is suspended under any order or with the consent of the Secretary." Appellant contends both that its wells were capable of producing in paying quantities, and that the production requirement was suspended either by the oral cease work order from Survey on September 1, 1977, or because of the difficulties encountered in drilling the wells.

The decision of the Director held that none of the wells was a well capable of producing oil or gas in paying quantities. Therefore, appellant was not entitled to 60 days' notice to place the well(s) in a producing status. Nor was ARMCO saved by the suspension provisions of the law. No suspension application, as required by 43 CFR 3103.3-8(a), was ever filed by appellant. "Moreover, Department regulations provide that only the Secretary may approve a suspension of leases in nonproducing status, that is, where there is 'the absence of a well capable of production on the leasehold.' 43 CFR 3103.3-8(a); Jones-O'Brien, Inc., 85 I.D. at 91" (Director's Decision at 4). The alleged instructions from Survey employees to cease operations were found not to be suspension orders protecting the leases from expiration. Finally, the Director ruled that appellant was aware of the expiration date and had adequate time within which to complete a producing well, that the delays were caused by appellant and not attributable to any act, omission or undue delay by Survey.

Section 17(j) of the Mineral Leasing Act of 1920, as amended, 30 U.S.C. § 226(j) (1976), and 43 CFR 3105.1-3 authorize the Secretary to alter the drilling and producing requirements of oil and gas leases in the public interest where they are committed to an approved cooperative or unit plan of development. Paragraph 25 of the Blair Mesa Unit Agreement provides in pertinent part:

All obligations under the agreement requiring the unit operator to * * * produce unitized substances from any of the lands covered by this agreement shall be suspended while the unit operator, despite the exercise of due care and diligence, is prevented from complying with such obligations, in whole or in part, by strikes, acts of God, Federal, State or municipal law or agencies, unavoidable accidents, uncontrollable delays in transportation,

inability to obtain necessary materials in open market, or other matters beyond the reasonable control of the unit operator. * * * No unit obligation which is suspended under this section shall become due less than thirty (30) days after it has been determined that the suspension is no longer applicable. Determination of creditable "Unavoidable Delay" time shall be made by the Unit Operator, subject to approval of the Supervisor. [Emphasis added.]

[1, 2] Appellant contends that the delays caused by inability to obtain equipment, faulty cement work, accidents and Survey's failure to grant more than four drilling permits and erroneous order to vacate the drill sites, were "unavoidable delays" and served to suspend the production requirement. Appellant misinterprets the meaning and effect of the last sentence quoted above. Regulation 43 CFR 3103.3-8 requires an application for suspension be filed with the area oil and gas supervisor, and the unit agreement does not supplant appellant's responsibility to comply with this regulation. It specifically makes the determination of "unavoidable delay" time subject to the supervisor's approval. Survey Officials are not authorized to waive the requirement of a written application for a suspension. If an application is not filed prior to the expiration of the lease, the lease terminates. Jones-O'Brien, Inc., 85 I.D. 89 (Secretary decision 1978). Notifying the district engineer, by telephone, of problems causing delay does not meet the requirements of the regulation. Furthermore, suspension of production requirements for leases of lands on which there are no wells capable of producing in paying quantities must be approved by the Secretary; this authority is not delegated to officers of the Department below the Secretarial level. Moreover, even the Secretary may suspend only in the interests of conservation. 43 CFR 3103.3-8(a); Jones-O'Brien, Inc., *supra*. Therefore, in light of our agreement with the Director that there is no well capable of producing oil or gas in paying quantities, any advice from the district engineer could not suspend the production requirement. Duncan Miller, 21 IBLA 361 (1975).

Appellant next asserts that Survey did not comply with the termination procedures required by law and, therefore, the leases have not expired. Appellant relies on section 17(f) of the Mineral Leasing Act, as amended, 30 U.S.C. § 226(f) (1976), and 43 CFR 3107.3-2. The regulation echoes the statutory language and provides:

No lease for lands on which there is a well capable of producing oil or gas in paying quantities shall expire because the lessee fails to produce the same, unless the lessee fails to place the well on a producing status within 60 days after receipt of notice by registered mail from the Area Oil and Gas Supervisor to do so: * * *.

It is appellant's position that there was a well capable of producing oil or gas in paying quantities within the meaning of the regulation and the statute. The arguments it makes on this point were also made to the Director, Geological Survey, and included for support, an affidavit by Keith M. Hebertson, a vice-president of the company, who was charged with the responsibility of supervising the oil and gas exploration and production operations conducted by appellant within the unit. In that affidavit, Hebertson sets forth a summary of his own personal qualifications and experience, and also a summary of activities conducted by appellant with relation to the Blair Mesa Unit. These include some of the activities mentioned previously. Appendix B attached to this decision sets forth the most relevant statements by Hebertson on the issue of whether there was a well capable of production, beginning with paragraph 15 of his affidavit.

[3] Where Survey has not had an opportunity to review evidentiary matter submitted on appeal to this Board or where an appellant has not been allowed to conduct a test to show that there was a well capable of production on the termination date of a lease, this Board has remanded cases for further consideration, including the possibility of a hearing if the factual controversy between Survey and an appellant persists following further review. E.g., Universal Resources Corp., 31 IBLA 61 (1977); Emily H. Oien, 25 IBLA 193 (1976). These considerations do not pertain here, however. Appellant was allowed to conduct a test after the termination date of the lease for the purpose of ascertaining whether the well was capable of producing oil or gas in paying quantities. The information it has submitted to this Board had also been considered by Survey when it made its decision. There is no basic dispute on the facts in this case, but only on the proper application and interpretation of those facts and of the meaning of the phrase "well capable of producing oil or gas in paying quantities." In view of this, no hearing is warranted in this case.

Appellant has also requested an oral argument before this Board. However, as its position has been well briefed, granting an argument would only delay resolution of this case and we see no useful purpose to be gained thereby. Accordingly, the request is denied.

[4] In construing the phrase "well capable of producing oil or gas in paying quantities" appellant contends that the legislative history read with other provisions in 30 U.S.C. § 226(f) indicate that actual production is not required to demonstrate capability. We agree that actual production is not necessary. However, we do not find support in the legislative history for an interpretation of the phrase which would suggest that something other than actual established physical capability of a well to produce oil or gas in paying quantities may be sufficient. A portion of the legislative history of section 17(f) relied upon by appellant states:

This amendment is needed because leases in their secondary term must be terminated if there is no production. This works inequitably in the case of lessees who in good faith have expended money to develop a well capable of production, when production must be suspended because of lack of pipelines, roads, or markets for the oil and gas. It seems only fair to give such lessees a reasonable period within which to place the well on a producing status.

1954 U.S. Code Cong. & Ad. News 2700.

This legislative history shows a concern for lessees who have expended money to develop a well capable of production. The emphasis on production being suspended suggests a well where there has been production or where production can clearly be obtained but is not because there is a "lack of pipelines, roads, or markets for the oil and gas." There is no suggestion that the mere existence of a well suffices where it is not physically capable of producing oil or gas in paying quantities.

Appellant asserts that the test for capability of a well should be where the well is "susceptible of, and * * * [has] the attributes required for production of commercial hydrocarbons in paying quantities." It asserts it is sufficient that "expert analysis indicates the presence of commercial hydrocarbons which are recoverable in paying quantities." It then contends there has been such an expert analysis and specifically refers to the Schlumberger analysis dated September 16, 1977. That analysis, however, does not show the existence of hydrocarbons in paying quantities. All it shows is that "water saturation values * * * are within the range of those normally encountered in hydrocarbon producing reservoirs." This supports, at most, only an inference that the water saturation is comparable to producing leases and should not be a problem. This would be a factor in evaluating the capability of the well to produce in paying quantities if there were other relevant and probative evidence demonstrating a well's productive capability.

The only other peg on which appellant can hang its position that there is a well capable of producing oil or gas in paying quantities is Hebertson's opinion to that effect. That opinion cannot be accepted here. The recited facts in his affidavit do not furnish a satisfactory basis upon which to support that conclusion. They give support only to possible inferences that there may be commercial quantities of oil or gas because of the proximity of a well to producing wells and favorable geological conditions, but do not establish that there is oil or gas in paying quantities or that there is a well capable of producing such.

Appellant refers to the fact that casings on the four wells were perforated and that the No. 17-1 well was fractured prior to the

termination date of the lease. However, while perforation of a well may be a sine qua non to establish the capability of a well for production, it does not follow that a well is capable of production merely because the casing has been perforated. Obviously, perforation can be made in the absence of a deposit of hydrocarbons. The same logic applies to the act of fracturing. Likewise, the fact that flammable gas was swabbed from each well following perforation, as cited in the affidavit, does not prove the existence of gas in paying quantities or the capability of the well to produce.

Appellant's position must rest on a possible potential prospect for production from the wells. This is not adequate. As we indicated, actual production as of the date of expiration of the lease need not be shown. However, there must be shown an actual capability, rather than a potential capability, to produce. It is long established that to meet the requirements of 30 U.S.C. § 226(f) the well must be in an actual physical condition to produce. Polumbus Corporation, 22 IBLA 270 (1975); Arlyne Lansdale, 16 IBLA 42 (1974); Joseph C. Sterge, 70 I.D. 375 (1963); United Manufacturing Co., 65 I.D. 106 (1958). While appellant has attempted to distinguish these cases, the basic principles are applicable here. It is evident that even if wells have good or excellent prospects of being profitable this does not alone warrant a finding that there was a well capable of producing in paying quantities on the date of termination. United Manufacturing Co., supra. In addition to establishing that a well itself is physically able to produce oil or gas, it must be shown that production would be of sufficient quantities to yield a reasonable profit over and above the costs of operating the well and marketing the product. Polumbus Corporation, supra. This has not been shown.

The difficulty with appellant's position is that it has not refuted the conclusion reached in Survey's decision at page 3 that "[a]s late as September 19, 1977, appellant had been unable to run a single successful flow test. Thus the 60-day notice requirement of section 17(f) was inapplicable." We agree that a test demonstrating the capability of the well as of the termination date was essential. Survey's experts have analyzed the data submitted by appellant. In the absence of adequate reasons establishing that Survey's conclusions are in error, we see no justification for disturbing its decision in this case. Cf. Corrine Grace, 30 IBLA 296 (1977).

Appellant's final reason for appeal is its general assertion that "[i]n fairness and equity the Department of the Interior is estopped from asserting that the subject leases have terminated." Appellant's brief to this Board does not address this point. However, from its previous briefs it appears to base the estoppel argument on the alleged delay by Survey in approving the unit agreement and drilling plans, and the cease work order of the district engineer on September 1, 1977. Even if that doctrine were applicable, there

are not adequate grounds for an estoppel here. It appears from the record that Survey was not the cause of the delays. The unit agreement was approved shortly after appellant submitted the necessary documents. One well was approved in February, the others in May 1977. Drilling was not begun until June 1977. These and other delays experienced by appellant were not the fault of Survey. As for the alleged cease-work order, we agree with the Director's conclusion:

Since [appellant] initiated the call solely because he was unable to conclude testing any of the wells before the expiration date of the leases, appellant would not have been prejudiced even if [appellant] had been told to stop work one day early. Thus appellant's failure to complete testing and to establish the existence of a well physically capable of producing unitized substances in paying quantities prior to the expiration of the leases may not properly be attributed to any act, omission or undue delay by the Geological Survey.

See generally 43 CFR 1810.3; Atlantic-Richfield Co. v. Hickel, 432 F.2d 587 (10th Cir. 1970).

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

Joan B. Thompson
Administrative Judge

We concur.

Anne Poindexter Lewis
Administrative Judge

Edward W. Stuebing
Administrative Judge

APPENDIX A
Leases

C-0100022-A

C-0100080
C-0100080-A
C-0100166
C-0100166-A
C-0100255
C-0100270
C-0101832
C-0104442
C-0104444
C-0106267
C-0106267-A
C-0117749
C-0118815
C-0118833
C-0123037
C-0124429-A
C-0124898-A
C-0126430-A
C-0127537-A
C-0127609
C-9228

APPENDIX B

Portion of Keith M. Hebertson's affidavit dated July 6, 1978:

15. Actual drilling commenced on June 3, 1977, and the four approved wells, denominated 18-1-S, 17-1, 17-2, and 17-3 were completed and cased on July 14, 1977.

16. A completion rig was not available until July 12, 1977, when such a rig was installed on well No. 18-1-S.

17. The drill rig operator fired his work crew in July of 1977 for cause, causing additional delay.

18. After favorable Schlumberger analysis of the No. 18-1-S well, it was perforated on July 13, 1977. After perforation, it became apparent that a permeability problem existed and that the cement crew had inadvertently created a cement block in the formation. For this reason, in view of the pending expiration of the leases, the completion rig was moved to the No. 17-1 well. The No. 17-1 well was "logged" and perforated on July 18, 1977. Again, Schlumberger analysis indicated the presence of hydrocarbons in commercial quantities. However, further analysis indicated that the cement installation was defective. That is, the cement was not of sufficient strength to allow stimulation.

19. Due to the defective cement work on the No. 17-1 well, the completion rig was moved first to the No. 17-2 well and subsequently to the No. 17-3 well. Inspection of the bond logs on both wells indicated that the cement bonds were of inadequate strength.

20. In consideration of all circumstances, a decision was made to attempt completion on the No. 17-3 well. That well was perforated and acidized on July 22, 1977. Subsequent cleaning indicated that surface water was entering the well precluding completion. In view of the increasing unanticipated delay, the U.S.G.S. District Engineer was notified of the existing problems on August 5, 1977.

21. The completion rig was then transported to the No. 17-2 well and after unsuccessful attempts at stimulation was placed at the No. 18-1-S well on August 18, 1977. Again, due to defective cement work, surface water continued to process the tubing was dropped and the retainer was inadvertently set at 125 feet. This necessitated obtaining a wire line drill to remove the

retainer. Such a drill was not available in that area until August 23, 1977.

22. Between August 19, 1977, and August 25, 1977, the No. 17-1 well was cleaned and on August 28, 1977, a second bond log was conducted and found to be satisfactory. The well was then fractured with sand and jelled acid.

23. At this same time, a wire line drill was obtained for the No. 18-1-S well to remove the dropped cement retainer.

24. On August 31, 1977, cleaning of the No. 17-3 well was completed and the well was perforated and prepared for a jelled water fracture which was to take place on September 1, 1977.

25. On September 1, 1977, your affiant contacted the U.S.G.S. District Engineer by radio-telephone to request additional time to complete testing. Your affiant was referred to the Casper U.S.G.S. office and was informed by that office that the leases had expired as of midnight on August 31, 1977. He was instructed to abandon the property.

26. In compliance with these instructions, your affiant informed the work crew that their services would not be required.

27. The order of the Casper U.S.G.S. office was then rescinded by the District Engineer, who informed your affiant that the termination date on the leases was September 1, 1977 rather than August 31, 1977. The District Engineer authorized ARMCOR to continue development on the wells; however, on September 2, 1977, the District Engineer restricted this authorization and informed your affiant that new drilling would not be permitted and that the well should be prepared for testing.

28. Unfortunately, the work-over rig necessary for testing preparation fell off a mountain road during transportation to the well site. It was impossible to retain a replacement rig until September 6, 1977.

29. On September 6, 1977, a new work-over drill rig was installed on the No. 18-1-S well which was cleaned and fractured with jelled water and sand. Cleaning operations continued through September 16, 1977, when a water analysis indicated fresh water seepage.

30. On September 19, 1977, a Schlumberger analysis was conducted on each well. This analysis indicated the

presence of commercial hydrocarbons and was submitted to the District Engineer along with a request for authorization to conduct further operations to prepare the wells for production. This request was refused and the District Engineer ordered that all operations cease.

31. Each well drilled is located in close proximity to wells which have established commercial production. The No. 17-3 well is located within 4,200 feet of the Victor Caldwell No. 20-1 well which produces in excess of 20,000,000 cubic feet of natural gas each month and has done so since January of 1973.

32. All four of the subject wells have penetrated the Wasatch formation from which the Caldwell and eight other nearby wells produce.

33. The geological conditions in the subject wells are similar to those of producing wells.

34. The analysis prepared by Schlumberger Well Services, a copy of which is attached hereto, indicates that there are potential hydrocarbon productive intervals in all four wells.

35. In your affiant's experience, the service companies such as Schlumberger Well Services, do not make any recommendations concerning development and operation.

36. Based on his experience, it is your affiant's opinion, that due to potential liability these service companies specifically Schlumberger Well Services present the most conservative analysis possible, consistent with available data.

37. It is the professional opinion of your affiant, based upon personal experience, in conjunction with drilling reports and additional data, that the water resistivity of the formation as submitted by Schlumberger Well Services is not 0.80 ohms/meter but rather it is 0.50 ohms/meter or less. The lower rating renders the results of electrical analysis more indicative of production potential, thereby increasing the number of favorable zones in each well.

38. During drilling operations, flammable gas was swabbed from each well following perforation and was also swabbed subsequent to stimulation treatment in the No. 17-1 and No. 18-1-S wells.

39. In the No. 18-1-S well, casing pressures as high as 600 psig developed during cleaning operations following fracture treatment with sand and jelled water.

40. Following a jelled acid treatment on the No. 17-1 well, flammable gas and substantial volume of highly gas cut acid was swabbed from the well. During the cleaning operations from the No. 17-1 well, casing pressures of more than 400 psig developed indicating the presence of flammable gas in the formation.

41. Your affiant has completed an independent empirical analysis of the subject wells. It is your affiant's opinion, based on his expertise, that the subject wells are capable of production of commercial hydrocarbons in paying quantities. This analysis is based on methods which have been derived by Schlumberger Well Services, Welex (Halliburton), and other similar service companies. The methods used in this analysis have general acceptance and are used in the day to day operating decisions of all bona fide operators in the United States.

